

AR43

**Reserve Oil and Gas Company
1972 Annual Report**



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Chairman of the Board

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Paul D. Meadows, Calgary
President, Canadian Reserve Oil and Gas Ltd.

Howard C. Pyle, Los Angeles
Petroleum Investments

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*Elected February 1, 1973

Officers

Newton T. Bass, Apple Valley
Chairman of the Board

John R. McMillan, Los Angeles
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Walter E. Cramer, Jr., Apple Valley, Vice President

Robert E. Aberley, Apple Valley, Treasurer

Annual Meeting

The Annual Meeting of Shareholders will be held at 10:00 a.m. on April 16, 1973 in the Assembly Room, 3rd floor, 550 South Flower Street, Los Angeles, California. The regular notice and proxy statement will be mailed to Shareholders in advance of the meeting.

Reserve Oil and Gas Company

Executive Offices:
550 South Flower Street
Los Angeles, California 90017

Financial and Operating Highlights

Financial	1972	1971
Total revenues	\$56,625,000	\$48,459,000
Income before extraordinary items	3,975,000	3,606,000
Per common share	.38	.34
Extraordinary items	1,168,000	200,000
Per common share	.13	.02
Net income	5,143,000	3,806,000
Per common share	.51	.36
Working capital	12,336,000	10,118,000
Shareholders' equity	63,277,000	58,534,000
Total assets	86,609,000	75,870,000
Operating		
Crude oil and natural gas liquids production, barrels per day	10,028	9,683
Natural gas sales, Mcf per day	35,955	34,122

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Discovery well at Tenaka in British Columbia during a snowstorm.

1972—A Year of New Records



- ✓ **Reserve:** A record year for gross revenues, net income and net income per share
- ✓ **Canadian Reserve:** A record year for gross revenues, net income and net income per share
- ✓ **Mohawk:** A record year for gasoline sales
- ✓ **Oil and Gas:** A record year for discovery of new oil and gas reserves
- ✓ **Apple Valley:** A year in which two major shopping center sites were sold



Production testing at the Kotcho discovery in British Columbia.

From the President

1972 was an outstanding record year for your Company in virtually every respect, including all significant financial categories and also in the discovery and initial development of major new oil and gas reserves.

GROSS REVENUES were at a record high of \$56,625,000, up 17% from \$48,459,000 in 1971.

NET INCOME was at a record high of \$5,143,000, up 35% from \$3,806,000 in 1971.

NET INCOME PER SHARE reached a record high of 51¢, up 42% from 36¢ in 1971.

WORKING CAPITAL at year-end 1972 reached a peak of \$12,336,000, up 22% from \$10,118,000 at year-end 1971.

FUNDS FLOW was \$10,384,000 in 1972, a record figure, up 36% from \$7,626,000 in 1971.

After a 1970/71 interval without an acquisition or merger, late in 1972 Reserve took the initial steps which will result, with final shareholder approval in April, in another major merger. Given such approval of the shareholders of both companies on April 16, Western Crude Oil, Inc. of Denver will become a wholly-owned operating subsidiary of Reserve and your Company will become a more fully integrated oil and gas company. Details of this transaction will be contained in a proxy statement which you will receive.

Late in 1972 your Company made another important move when it arranged to acquire a 12½ % interest in 3 million acres in the Napo-Putomayo Basin of Colombia, South America. These lands are northerly and on trend from the prolific finds made in Ecuador in recent years.

Activity in the frontier areas of Canada, where Reserve has substantial acreage holdings, continues at a high pace. The MacKenzie Delta area of the Northwest Territories continues to experience oil, gas and condensate discoveries.

The Drake Point Gas Pool, discovered in 1969 on Melville Island in the Arctic, was extended some 6 miles by 2 wells drilled by Panarctic during the year. There was further excitement in the Arctic at the oil discovery in the Thor well on King Christian Island when the well flowed 40 gravity sweet oil from 3870 feet, and early in 1973 Dome Petroleum reported a successful formation test of a gas sand from a large structure on the north end of King Christian Island.

Canadian Reserve has agreed to participate in its first Arctic Prospect well, which will be known as the Horn River Middle Fiord K-52 Well, on Axel Heiberg Island. This wildcat well will be taken to a depth of 8500 feet to evaluate the Heiberg sandstone of Triassic age.

The Company continued its program of farming out blocks of its extensive Canadian exploratory holdings by concluding farmout arrangements with others on 1,567,197 acres in the Beaufort Sea, 2,439,785 acres in the McClure Strait, 1,227,013 acres in the Queen's Channel,



and 1,708,838 acres in the eastern Canadian offshore area, a total of 6,942,833 acres of the Company's permit lands.

In northeastern British Columbia your Company successfully participated in 9 wildcat discovery wells, 8 gas and 1 oil. The details of the tests on these important wells can be found in the accompanying text.

The most significant discovery was of a gas field from a Middle Devonian Reef in the Kotcho Area. At a depth of 6550 feet this well tested an absolute open flow potential of 210 million cubic feet of gas per day. This is the largest gas well in Reserve's history. Canadian Reserve holds a 37½ % interest in 56,000 gross (21,000 net) acres of leases and drilling reservations. Two other shallow formations in this well indicated commercial gas production.

A well is currently being drilled on a structure just southeast of Kotcho and is projected to the Devonian Reef. This well has already produced gas on a formation test of a shallow sand.

When all these gas reserves are finally developed it is entirely possible they will double the gas reserves of the Company.

In Saskatchewan, where the Company has conducted an aggressive exploration and development program on its extensive land holdings, a major farmout to another company was negotiated by Canadian Reserve and its partner during 1972. Under this program 25 exploratory wells were drilled prior to the end of the year and production casing has been set on 7 of these wells, 5 of which are indicated oil discoveries and 2 of which are indicated gas discoveries. It is apparent from the discoveries that have been made that substantial development will be entered into by Canadian Reserve,

which retains a 25% interest in these discoveries. The increasing development of production in Saskatchewan and Southeast Alberta assures another increase in the throughput for 1973 for the Lone Rock-Kerrobert Pipeline in which Canadian Reserve owns a 47½ % interest.

In the Crossfield East Elkton Unit, located some 30 miles northeast of Calgary in Alberta, the Company participated in the development of the oil ring down-dip from the gas cap. Three wells in which the Company has an interest were completed as flowing oil wells. The development of this Elkton Zone is proceeding at a rapid pace and we anticipate a significant increase in Canadian Reserve cash flow as a result of this development drilling program.

All signs point to continuing growth in Apple Valley. Property sales of lands owned by the Company and by others totaled \$3 million, up 34% from the equivalent \$2.2 million 1971 figure. Housing starts totaled 149, up 39% from the prior year and at the highest level since 1964. Burgeoning Apple Valley recreational facilities are an intangible but increasingly important factor in the continuing uptrend of this area. The vigor of the Apple Valley growth potential is attested to by consummation of plans for construction of two major supermarkets and connected shopping center facilities in central Apple Valley locations, both scheduled for major construction activity in 1973.

Mohawk Petroleum had a record year in the refining and marketing business. Gasoline sales were at an all-time high of 136 million gallons for the year, a 32% increase over 1971, which had also set a record for Mohawk at 103 million gallons. Mohawk products are marketed through 307 retail sales outlets, up from 241 in 1971. Part of this expansion arises from establishing 18 new low-cost gasoline marketing outlets in connection with small consumer-oriented merchandising

businesses in 1972. These outlets provide greater returns to Mohawk in relation to investment than conventional service stations and their increasing utilization tends to heighten the profitability of Mohawk's marketing operations.

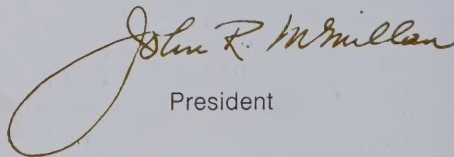
The Mid-Continent production payments were retired in 1972. What this means is that Reserve will now have the funds that had been dedicated to the principal and interest of these payments available for other purposes, including exploration if deemed desirable. To illustrate the magnitude of these funds, they amounted to \$2.5 million in 1970, \$2.7 million in 1971 and \$2.7 million in 1972.

In February of 1973, Malcolm McDuffie was elected to the Board of Directors. Mr. McDuffie has been President of Mohawk since it was acquired by Reserve in August of 1969.

We note with sadness that Jasper W. Tully, a founder of the Company, died in December, 1972. His career with Reserve encompassed a noteworthy period of thirty years as President.

1973 will very likely be a year of great change and challenge for natural resources companies. A new national energy policy appears probable with the ever-increasing demand for supplies of energy, particularly oil and gas, and no end is in sight to this upward demand curve. New opportunities for Reserve to further diversify, to grow and achieve new financial plateaus seem virtually assured. Such opportunities will be vigorously pursued. The dedicated past efforts of your Company's outstanding staff hold promise for achievement of continuing growth.

For the Board of Directors


President

March 16, 1973

Exploration, Development and Operations



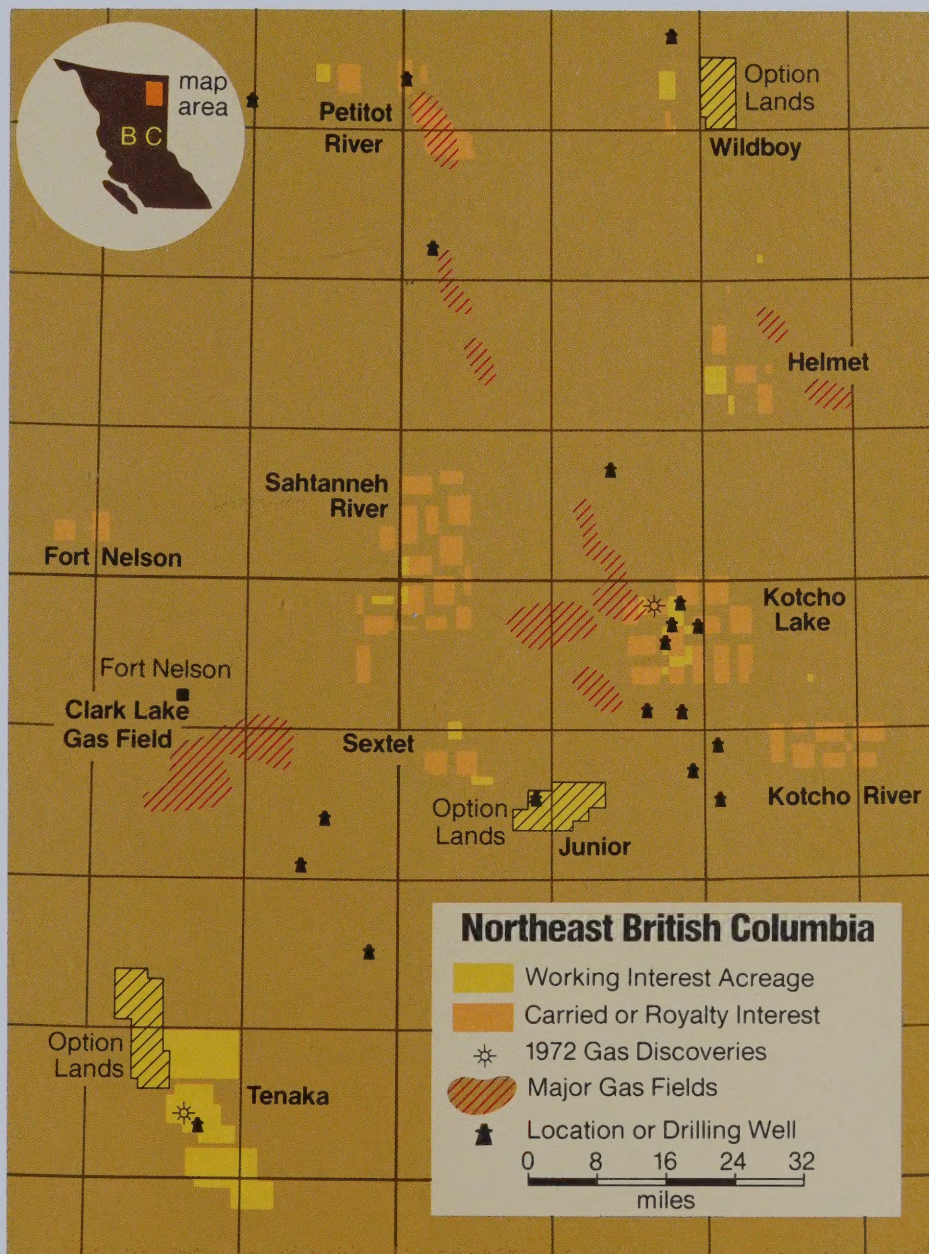
Canadian Reserve Oil and Gas Ltd.

Land: At December 31, 1972, Canadian Reserve held interests in 22.0 million gross acres and 13.0 million net undeveloped acres and overriding royalty interests on 4.2 million acres in the western provinces, the Arctic, East Coast, Yukon and Northwest Territories. In addition, productive land holdings of the Company in the western provinces of Canada amounted to 291,787 gross acres and 82,168 net acres.

Since acquisition of its large frontier land holdings in September of 1969, the Company has negotiated eleven farm-outs and sales agreements with other companies involving a total of 13.4 million gross acres, of which the Company will retain 5.1 million net acres if the farmees perform all exploratory commitments. Under terms of these various agreements the Company has recovered \$1,810,000 in cash plus exploration fund commitments which in total will require the expenditure of \$6.2 million, if all commitments are fulfilled.

In 1972 the Company concluded farmout arrangements with other companies on its land holdings in the Beaufort Sea, McClure Strait, Queen's Channel and Eastern Canada offshore areas. These arrangements cover 6,942,833 acres of the Company's permit land holdings. In late 1972 the Company contributed bottom hole money to the Panarctic-Dome Dundas well on Dundas Peninsula of Melville Island and acquired a 0.5% royalty interest in 271,500 permit acres on which the well is located. The well was drilling below 10,000 feet at year-end. In return for its contribution the Company obtained exploratory work credits of \$300,000 which will be applied towards retention of its nearby 1.8 million acre Melville Sound block.

The Company concentrated its efforts in 1972 on exploration for gas reserves in Northeast British Columbia, exploration

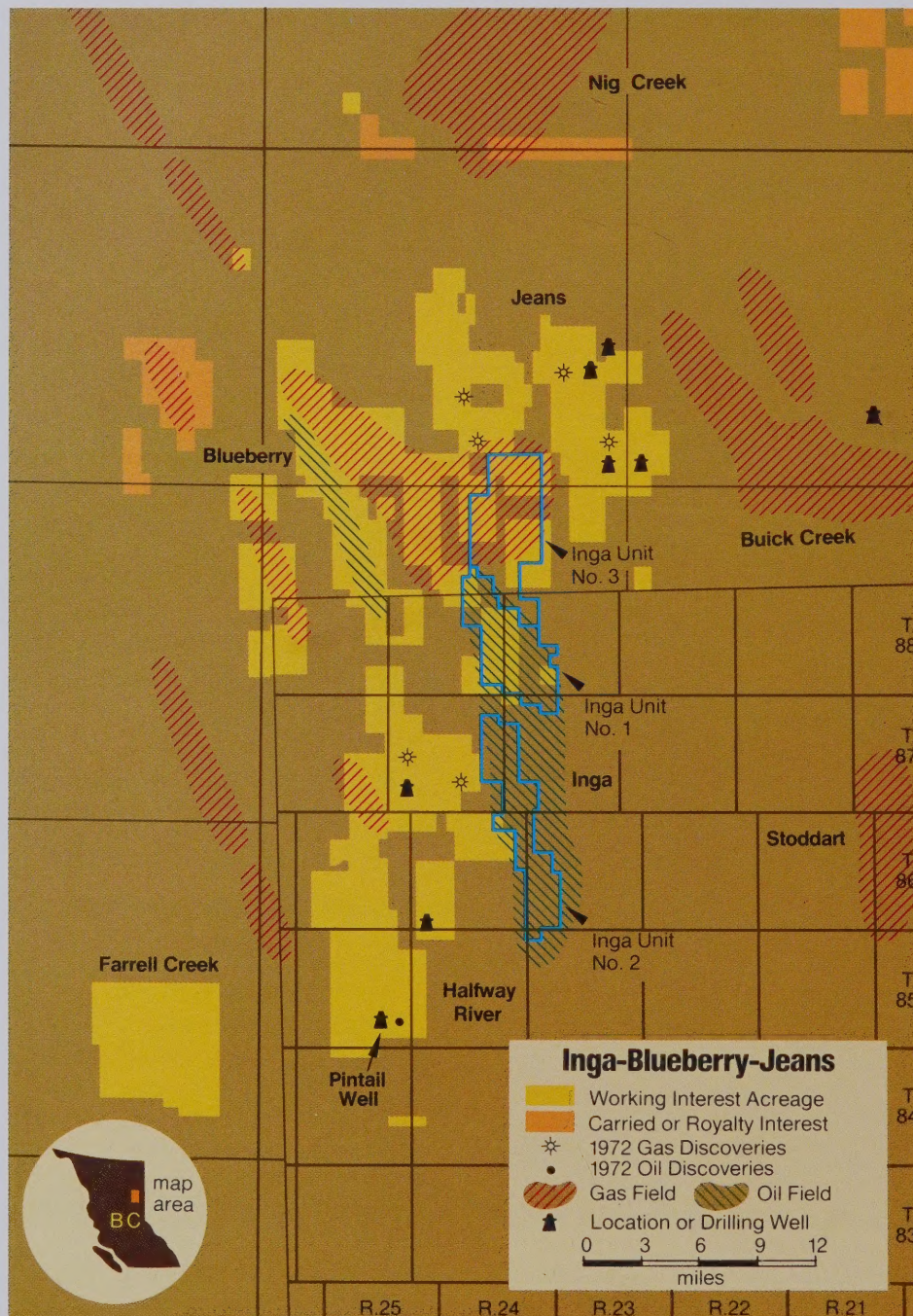


for and development of heavy crude oil reserves in the Saskatchewan/Alberta border area, and development of oil reserves in the Elkton formation within the Crossfield East Field of Alberta.

A summary of significant exploration and drilling activities conducted in 1972 follows:

Northeast British Columbia: Canadian Reserve owns 465,788 gross (131,536 net) exploratory acres in Northeast British Columbia in addition to 43,992 net developed acres.

The Company participated in 1972 with interests ranging from 10.8% to 50% in



9 successful exploratory wells (8 gas, 1 oil) in Northeast British Columbia. 1 major gas discovery, at Kotcho, is shown on the Northeast British Columbia map on page 5. Another gas discovery is shown on this map at Tenaka. The

other 6 gas wells are highlighted on the Inga-Blueberry-Jeans map above. The indicated oil discovery well at Pintail is also shown on this map.

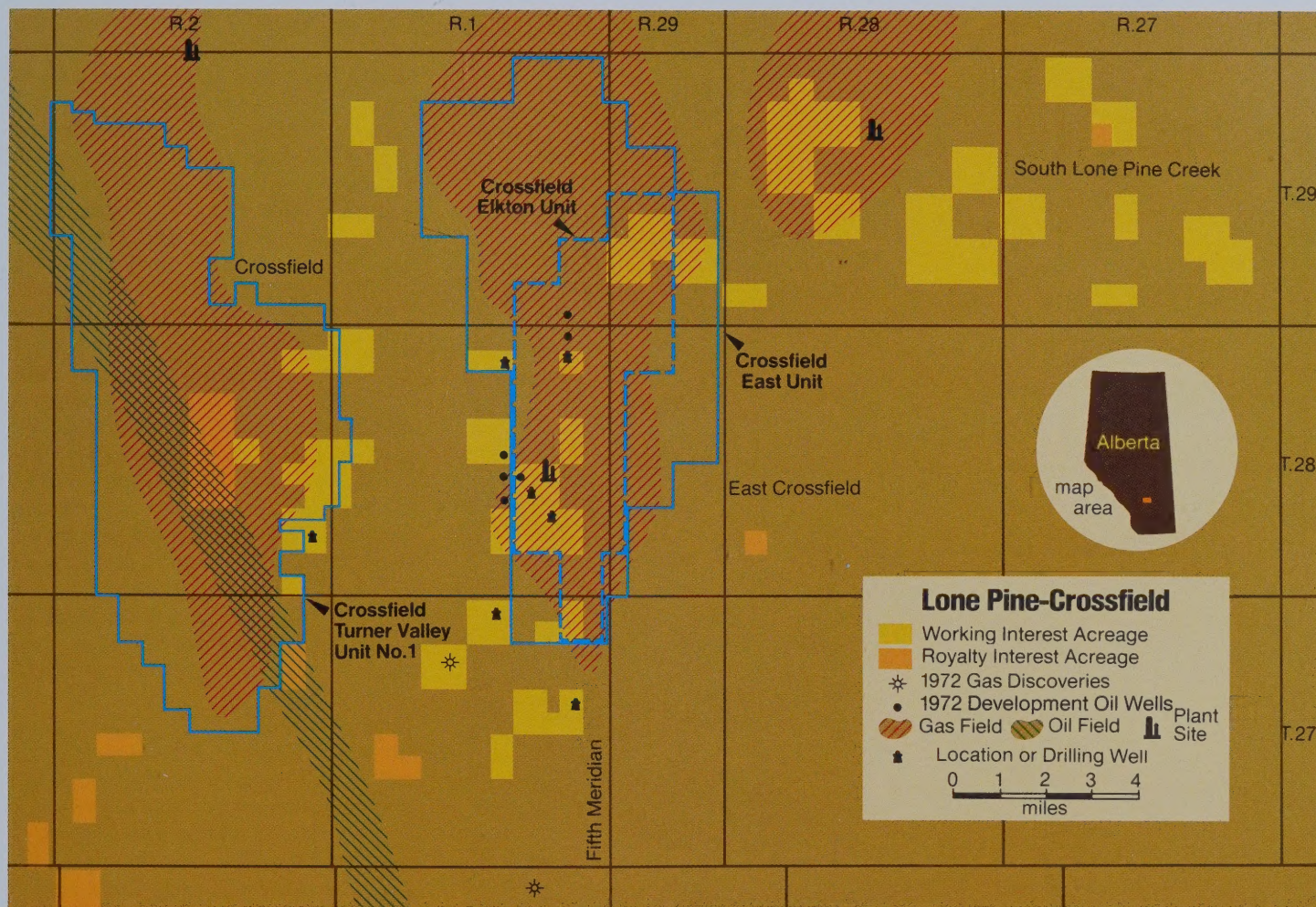
Jeans Area: Follow-up exploratory drilling to the Shenandoah, et al Jeans d-75-

A, a Dunlevy zone and Mississippian zone gas discovery completed in late 1971 at 6,951 feet, resulted in two successfully completed gas wells during 1972 within the 27,677 gross (4,484 net) acres in which Canadian Reserve owns an interest.

West Jeans Area: Two discoveries, 1 in the Inga sand at 4,700 feet and the other in the Dunlevy sand at 4,100 feet, in which Canadian Reserve retains interests of 10.8% and 16%, were drilled under the terms of farmout agreements in the local West Jeans area. The SOC Cardo West Jeans b-46-B well was completed as a gas well in the Inga sand with an open flow potential of 3.6 million cubic feet per day. The SOC et al West Jeans c-78-B well is in process of being completed as a gas well in the Dunlevy sand. Both wells will be completed as shut-in gas wells pending availability of market. Canadian Reserve owns a 10.8% to 21.6% interest in 20,296 gross acres, resulting in 4,480 net acres, within the immediate area of these 2 gas discoveries.

Inga West Area: Trans-Prairie Pipeline Co. completed 2 exploratory wells as gas discoveries at depths of 4,640 feet and 4,880 feet, in the Triassic sand on lands in the Inga West area in which Canadian Reserve retained a 10.8% interest. Canadian Reserve holds a 10.8% interest in 5,120 gross lease acres and a 14% interest in a 7,824 acre drilling reservation in the immediate area of these 2 discoveries.

Pintail Area: General American Oil Co., as Operator, drilled and completed an exploratory well in the Inga-Blueberry-Jeans (Pintail) area. The discovery well, the Pintail 2-12-85-25, was undergoing formation stimulation at year-end following initial tests at a depth of 4,700 feet which flowed 120 barrels per day of 41° oil. Canadian Reserve owns a 25% interest in the discovery well and some



26,939 gross acres (6,735 net acres) in the immediate area.

The search for Middle Devonian reef gas reserves was carried out under a joint venture with another participant. Canadian Reserve drilled 3 wildcat wells in this program, resulting in 2 gas discoveries: one on the Tenaka Prospect and the other on the Kotcho Prospect.

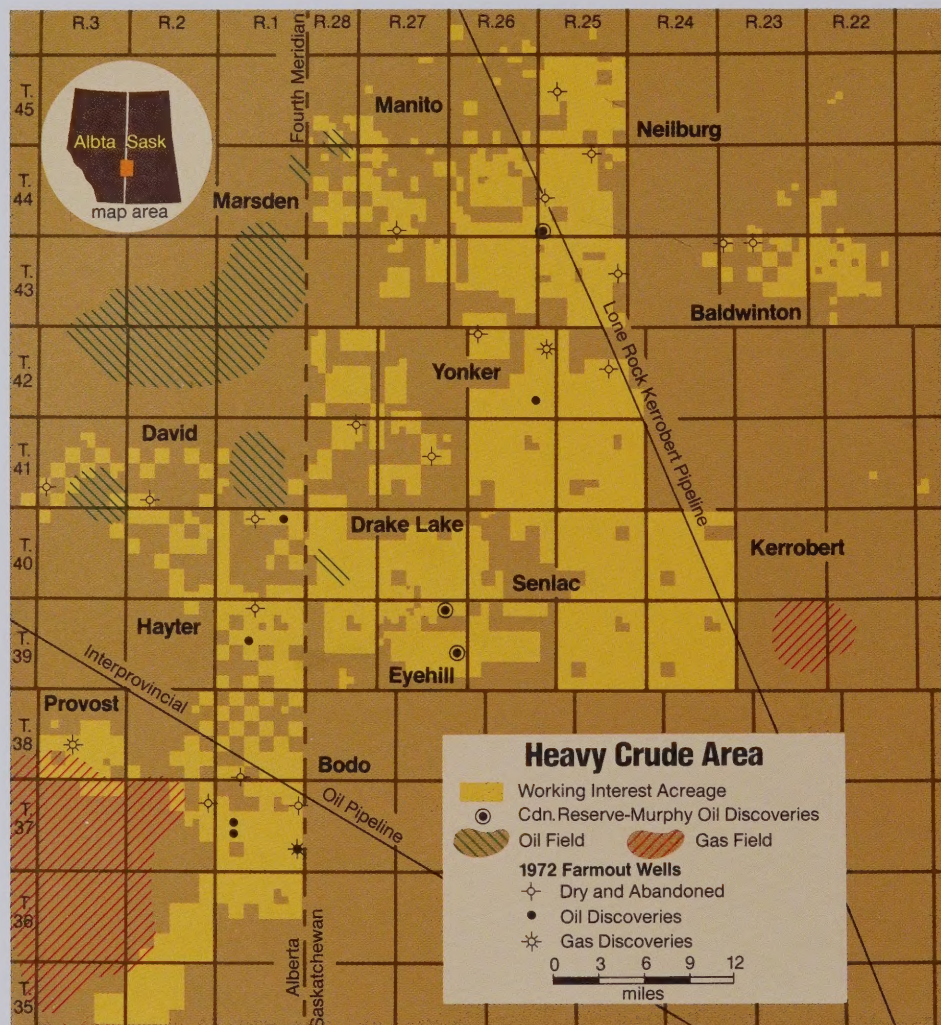
Kotcho Area: A significant new Middle Devonian Reef gas field is indicated by the completion in January 1973 of the b-43-J well on the Kotcho Prospect in the Middle Devonian at 6,550 feet with an absolute open flow potential of 210

million cubic feet of gas per day. In addition, the Bluesky sand at 2,000 feet was drillstem tested in this discovery well at 3.6 million cubic feet of gas per day. This high potential discovery well is located in an area in which Canadian Reserve holds a 37.5% interest in 56,000 gross (21,000 net) acres of leases and drilling reservations.

Tenaka Area: The a-36-G well at Tanaka was completed in August 1972 in the Devonian reef at 8,120 feet with an absolute open flow potential of 7.4 million cubic feet of gas per day. Canadian Reserve owns a 50% interest in the discovery well and 130,338 gross (52,069 net) acres in the prospect area.

At year-end, follow-up drilling and geophysical work were in progress on lands in both the Tenaka and Kotcho areas.

Alberta: During 1972, the Energy Resources Conservation Board of Alberta recognized the existence of oil pools downdip from the gas cap in portions of the Crossfield East Elkton Unit located some 30 miles northeast of Calgary, Alberta. In order to establish the performance inter-dependence of the oil and gas zones, this Board has recently approved an accelerated depletion rate for the oil zone. Well 1-22 has been completed on Canadian Reserve's



the year participated in the drilling of 31 exploratory wells, and 57 development wells on its land holdings in the area. As a result of this drilling program 53 gross (24.1 net) development wells were completed as producers, and 9 gross (2.5 net) exploratory wells were completed as oil discoveries and 2 gross (.5 net) were completed as gas discoveries.

Of the above 57 gross development wells, 17 were drilled under an infill development program in the Northwest Epping Field near Lone Rock, Saskatchewan. (See map page 9.) This program was initiated in conjunction with the development of a field gathering and treating system to serve 47 of Canadian Reserve's wholly-owned wells in the field. Production economics will be greatly enhanced as a result of this program due to increased oil recovery efficiency and elimination of costs associated with the trucking of produced oil and water.

As part of Canadian Reserve's exploration program on its extensive land holdings in the heavy crude oil area, a major farmout to another company was negotiated by Canadian Reserve and its partner during 1972. (Refer again to map on left.) The initial phase of this program was completed during 1972 by the drilling of 25 exploratory wells, of which 5 are indicated oil discoveries and 2 are indicated gas discoveries. At year-end, production casing had been set on these wells and production testing is scheduled for the first quarter of 1973. The farmee has also initiated the second phase of this exploration program under which he may earn an interest in additional lands by drilling up to 25 more exploratory wells in 1973 at his sole cost. If the farmee completes the optional second phase of this 50-well total program the Canadian Reserve interest in these lands will be reduced by 50%.

wholly-owned land and is undergoing oil production tests. Two other wells have also been drilled on Canadian Reserve's half interest lands, one of which is producing 500 barrels of 36° gravity oil per day while the other was nearing completion at year-end. See map on page 7.

A significant increase to Canadian Reserve's cash flow in 1973 is anticipated as a result of this development drilling program.

Saskatchewan: Canadian Reserve owns 17,465 gross and 13,681 net acres of oil and gas rights in the Lone Rock-Epping

heavy crude oil producing area of Saskatchewan. Within the various field areas there are 623 gross wells, including Unit wells, representing 259.4 net wells to Canadian Reserve. In addition, Canadian Reserve owns 533,575 gross and 245,764 net acres of exploratory lands to the south of the Lone Rock-Epping area along the Saskatchewan-Alberta border in both provinces. These lands are in proximity to the Lone Rock-Kerrobert Pipeline System. (See map above.)

During 1972 Canadian Reserve continued to place emphasis on exploration for and development of reserves in the heavy crude oil areas of Saskatchewan and Alberta. Canadian Reserve during

Canadian Reserve will participate as to its 25% interest in all subsequent development drilling on the 269,945 gross acres included in the farmout.

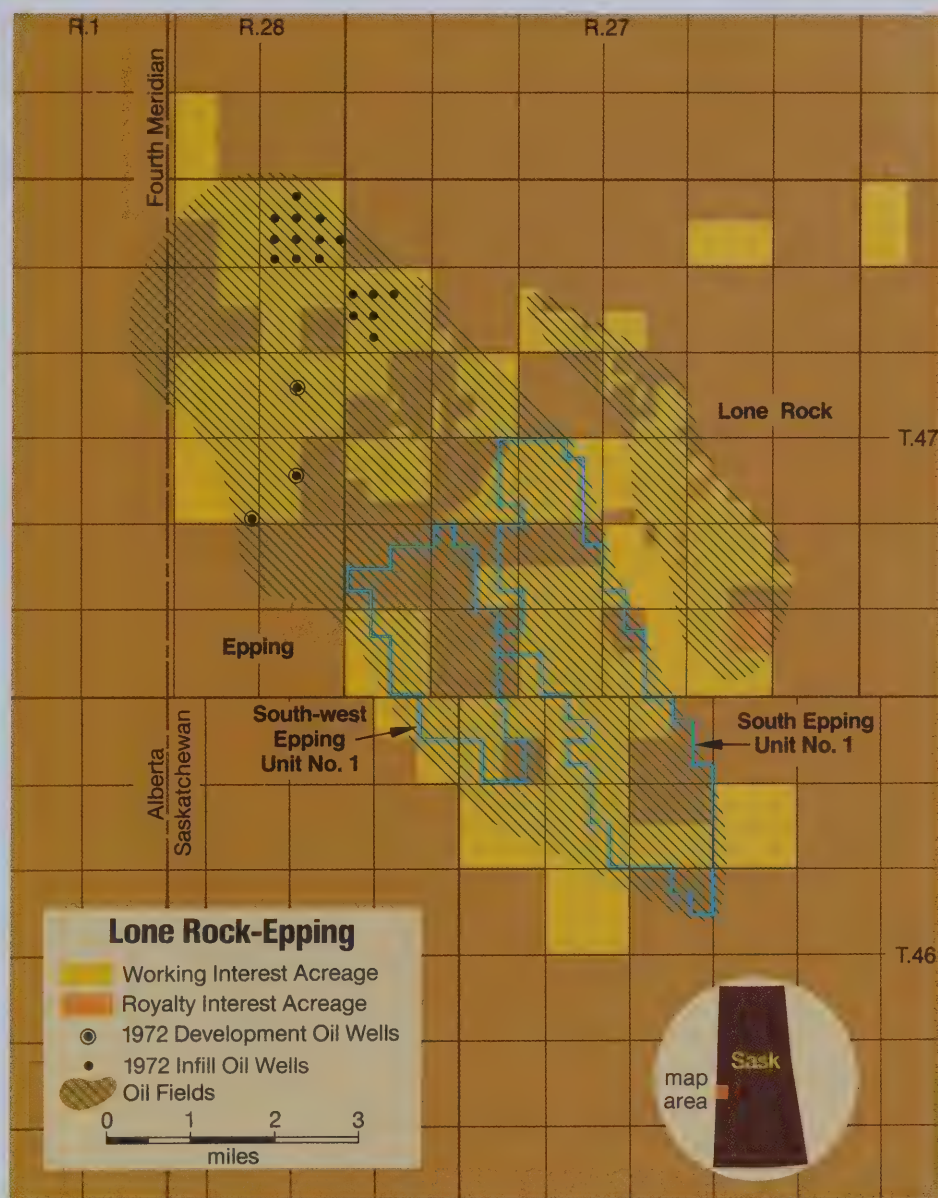
Accelerated evaluation of Canadian Reserve's vast land holdings in the area will be significant in discovering additional heavy crude oil reserves, eliminating substantial annual land rentals, and providing increased throughput for the Lone Rock-Kerrobert pipeline in which Canadian Reserve owns a 47.5% interest.

Yukon and Northwest Territories: During 1972, some 50 wildcat wells were drilled and some 30 locations were staked by the industry in this region making it the most active frontier exploration area in Canada. Approximately 20 of these wells were located in the Mackenzie Delta area where major gas and oil discoveries are indicated.

Canadian Reserve holds 3.6 million gross acres and 2.7 million net acres of oil and gas exploratory rights plus overriding royalty interests in 1.9 million acres in the Yukon and Northwest Territories. The map on page 10 depicts the Canadian Reserve land holdings and industry drilling activity in this vast region.

In 1972, extensive geophysical surveys were conducted by other companies under farmout agreements on our 664,428 acre Colville Lake and 879,504 acre Peel Plateau blocks. Additional exploration work will be conducted by these companies on the farmout lands during 1973.

Canadian Reserve plans to conduct geophysical surveys on surface structures on its wholly-owned land holdings in the general vicinity of Norman Wells in early 1973. These land holdings are favorably located along the Mackenzie River corridor through which pipelines

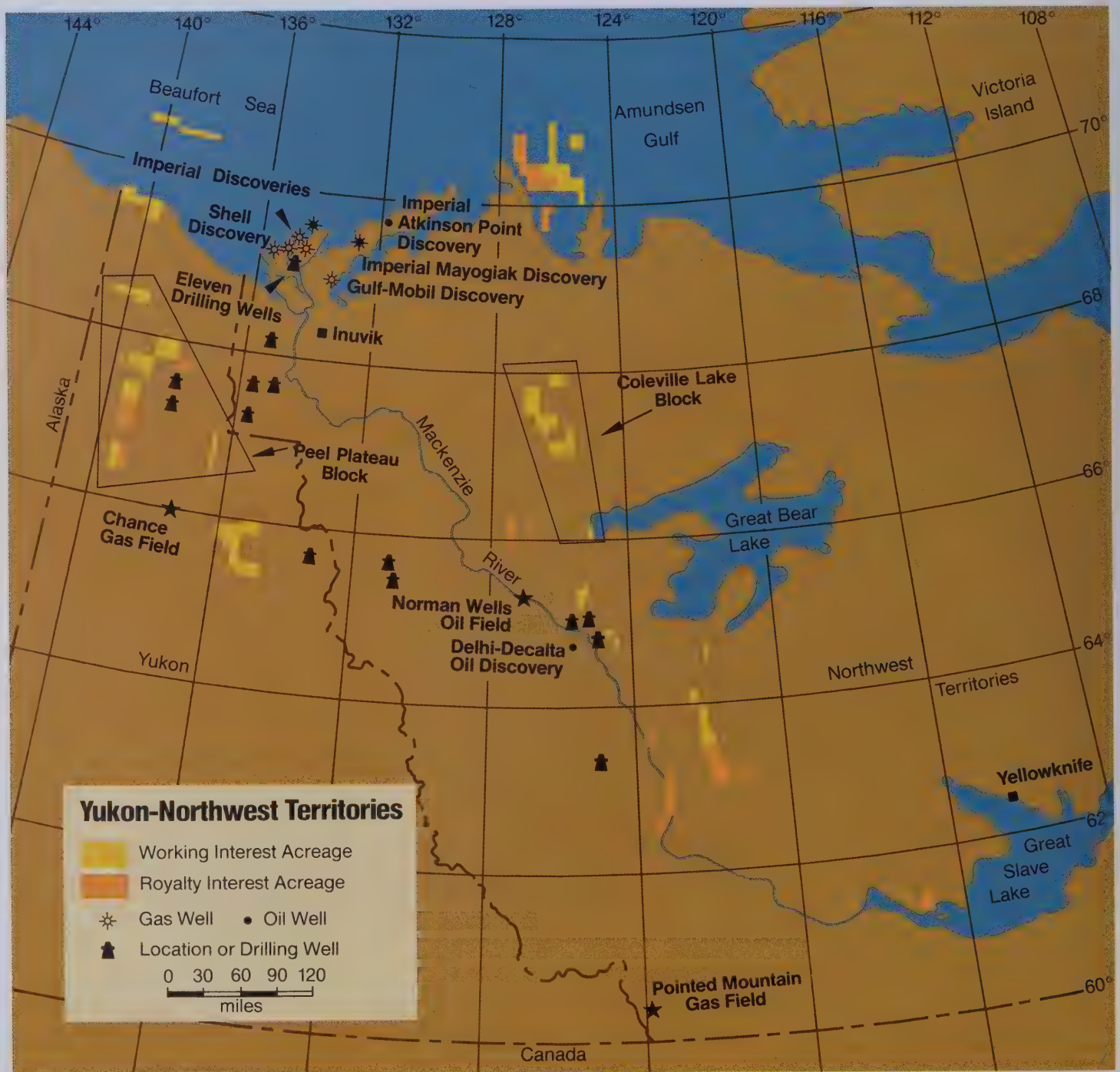


have been proposed to transport northern oil and gas to southern markets.

Arctic Islands: Canadian Reserve holds 11.2 million gross (7.9 million net) acres of exploratory oil and gas rights in the Arctic Islands. In addition, overriding royalties are owned under 1.4 million gross acres in this area.

During 1972, exploratory drilling by the industry confirmed major gas discoveries

in the Kristoffer Bay well, in the King Christian Island area and in the Hecla well on Melville Island plus an oil discovery in the Thor well in the King Christian area. In addition, oil shows were encountered in 3 zones in the Romulus test well on Ellesmere Island. The Drake Point gas pool, discovered in 1969, was extended some 6 miles by



two step-out wells drilled by Panarctic during the year. At year-end, 12 exploratory wells were drilling in the Arctic Islands. See map, page 12.

Canadian Reserve will watch with keen interest four wells drilling in the Arctic Islands at year-end. Three of these wells, Panarctic's Mokka A-02 and Gemini E-10 tests and Horn River's Depot Point L-24 test were drilling in the eastern

Arctic region in proximity to 2.5 million acres of Canadian Reserve's wholly-owned lands. Success in any of these test wells would have very favorable



Main tank battery, Southwest Epping Unit, Saskatchewan.

implications for Canadian Reserve's land holdings in the eastern Arctic region. The Panarctic Pollux G-60 test, drilling on the northwestern portion of Ellef Ringes Island is also significant to Canadian Reserve since it is in proximity to some 1.2 million permit acres farmed out to Dome Petroleum in which Canadian Reserve has retained a 50% interest.

Canadian Reserve has agreed to participate for a 14.3% interest in the Horn River Middle Fiord K-52 well on Axel Heiberg Island expected to be drilled in the second half of 1973. The test well will be taken to a depth of 8,500 feet to evaluate the Triassic sands on a surface feature some 8 miles in length. Canadian Reserve will pay 14.3% of the well cost to earn a 7.15% interest in the well and 271,000 permit acres.

Eastern Canada Offshore: The industry during 1972 recorded two offshore discoveries and one successful offset in the

Sable Island area of offshore Nova Scotia during 1972. One of the discoveries, Mobil-Tetco Thebaud, found sweet gas and condensate in five separate zones over a gross interval of 2,900 feet. The other discovery, Shell Primrose, was abandoned after having tested gas in three zones (36 million cubic feet per day total) and oil (300 barrels per day) in a fourth zone. Small but encouraging hydrocarbon shows have also been reported in some of the Amoco-Imperial wells drilled on the Grand Banks.

Canadian Reserve during 1971 conducted a 1,200 mile marine seismic program, and as a result of the program, released 5,836,033 acres and retained 218,256 acres of preferred permit land holdings in the Gulf of St. Lawrence and offshore Nova Scotia areas.

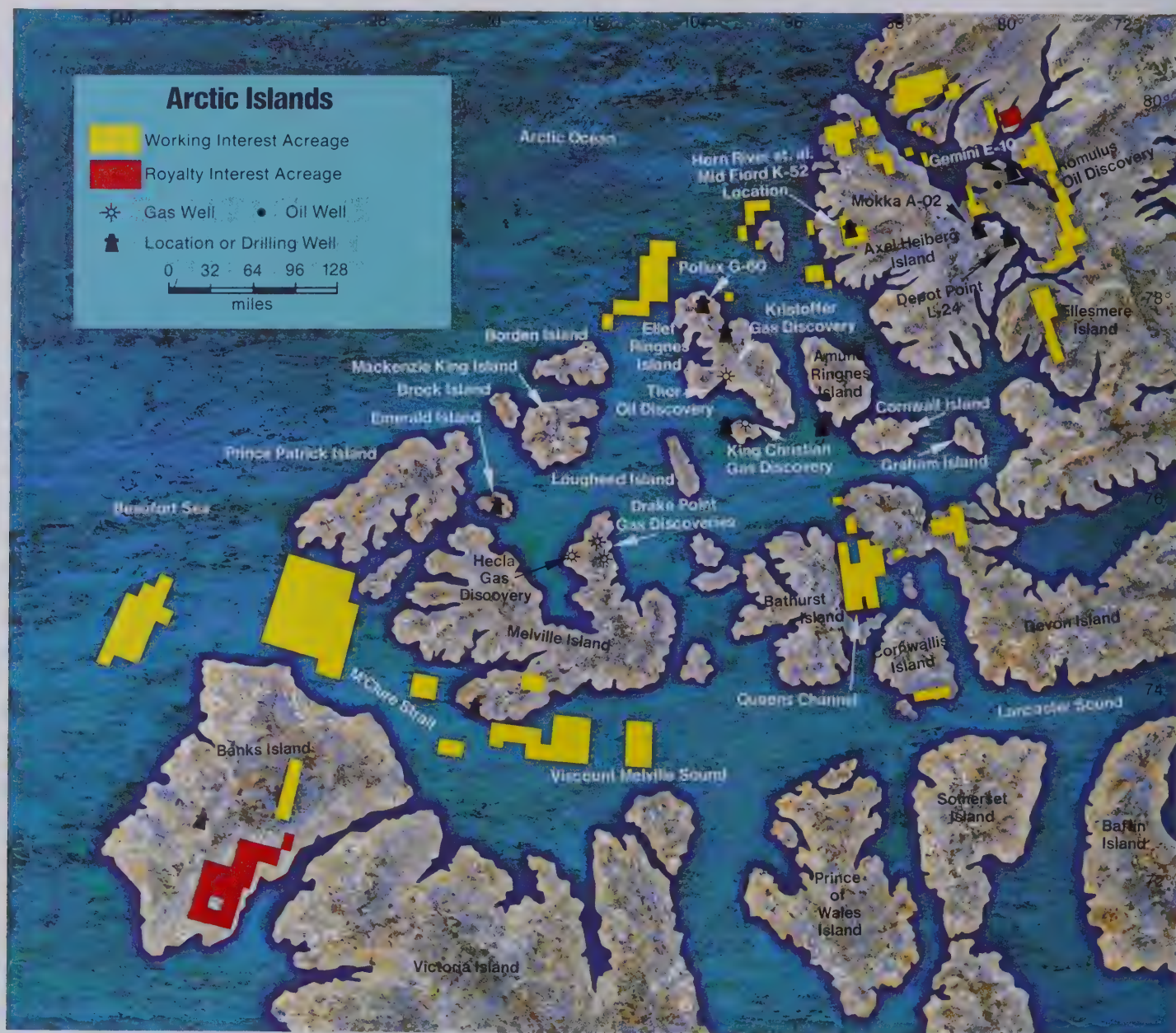
In 1972, permits totaling 4.8 million gross (1.7 million net) acres in the Grand Banks region were farmed out to a major company which has committed to explore this area during the next two years.

Operations:

Drilling: During 1972, Canadian Reserve participated in the drilling of 130 gross wells in western Canada resulting in the most active drilling program in its history.

Exploratory completions totaled 54 gross wells resulting in 11 oil and 10 gas completions and 33 dry holes for a success ratio of 38.9%. Canadian Reserve's interest in the successful exploratory completions resulted in 3.8 and 2.1 net oil and gas completions, respectively.

Of the 76 development wells in which Canadian Reserve participated during 1972, 72 were completed as oil wells and 4 were abandoned for a success ratio of 94.7%, resulting in the equivalent of 25.6 net oil well completions.



Production: Net production of oil and natural gas liquids during 1972 averaged 6,377 barrels per day for a 10.4% increase over the 1971 net production of 5,777 barrels per day. Net sales of gas in 1972 increased 25.2% to 18,282 MCF/D over the 1971 net sales of 14,604 MCF/D.

Net sulfur production during 1972 amounted to 148 long tons per day, an increase of 29 long tons per day from the 119 long tons per day in 1971. Canadian Reserve sold 47,330 long tons of sulfur during 1972 for a net back price of \$4.31 per long ton. Depressed sulfur prices prevailed throughout the year as sulfur inventories in western Canada continued to increase.

Transportation: The Lone Rock-Kerrobert pipeline in which Canadian Reserve has a 47.5% ownership is a 101-mile system which transports a crude oil-condensate blend from the heavy crude oil area of Saskatchewan to Kerrobert and then into the Interprovincial Pipeline for delivery in the Ontario and Chicago marketing areas. During



Pumping unit at Canadian Reserve Well Epping C-13-36-47-28

1972, there were 2,856,750 barrels of blend delivered to this Interprovincial line for an average of 7,862 barrels per day, an increase of 35% over the daily average for 1971 of 5,818.

In Northeast British Columbia Canadian Reserve owns a 21.67% interest in a 72-mile pipeline which transports crude oil from the Aitken Creek, Blueberry and Inga Fields to Taylor Flats for movement via other pipelines into West Coast refineries. This system, capable of handling 15,000 barrels per day, had income of approximately \$100,500 to Canadian Reserve's interest in 1972.

Natural Gas Processing: Varying interests (ranging from 0.67 to 33.3%) in 7 natural gas processing plants in Alberta are owned by Canadian Reserve.

The year 1972 marked the first full year of operation of the South Lone Pine Creek gas processing facilities in which

Canadian Reserve owns a 33.3% interest. The plant, treating the sour and wet gas from the Devonian D-1 formation underlying Canadian Reserve acreage, produced and sold 1,707 million cubic feet of sales gas, 45,379 barrels of condensate and produced 10,380 long tons of sulfur to Canadian Reserve's account.

In the East Crossfield area, some 30 miles north of Calgary, Canadian Reserve owns a 12% interest in gas processing facilities capable of handling 110 million cubic feet per day of sales gas from the D-1 and Elkton units. During 1972, Canadian Reserve's net production from the East Crossfield Unit totaled 2,761 million cubic feet of gas, 48,748 barrels of condensate and 46,087 long tons of sulfur to Canadian Reserve's interest.

Mid-Continent Division

In 1972 an average of 2,403 barrels of crude oil, condensate and natural gas

liquids per day and 12,486 Mcf of gas per day were produced and sold from the Mid-Continent properties, net to the Company's interest before application to production payments.

From funds generated by oil and gas sales, a total of \$2,623,000 was applied to principal and \$98,000 was applied to interest on the Mid-Continent production payment during 1972. The proceeds from oil and gas sales during the month of December, 1972 were sufficient to fully retire all of the remaining balance, plus accrued interest, on the oil payments.

Division activities during the year are summarized below:

Kansas: There continues to be an intense interest in the deeper horizons yet to be thoroughly explored for oil and gas in several counties in the southwestern

part of the State. The Company continues to hold oil rights below 3400 feet under 19,360 acres and both oil and gas rights below 3400 feet under some 2,640 acres located in Finney, Haskell, Kearney, and Seward Counties.

New Mexico: During 1972, there has been favorable response to the Company's operated water injection projects initiated during 1971. These projects include the Cooper Jal Unit, containing 95 wells, where there has been a noticeable increase in oil production of 73 barrels per day. Favorable response has also been noted in the Company-operated South Langlie Jal Unit which contains 27 wells. These Units produce from the Yates, Seven Rivers and Queen formations. The Company's interest in the two projects is 23.66% and 40.08%, respectively.

Water injection was initiated in the Teas Unit, where the Company owns a 25.11% working interest during June, 1972. This Unit produces from the Yates formation.

Texas: Continued good performance has been noted throughout 1972 as a result of the water injection program in the Company-operated GMK (San Andres) Unit. During the past few months, production from the Unit has increased from 1,369 to 1,618 barrels per day as a result of converting three additional wells to injection status. The Company's working interest in this very successful operation is 34.4%.

The Reeves (San Andres) Unit, containing 122 wells, continues to perform satisfactorily under a water injection program. The Company's working interest in this Unit is 10.12%.

The GMK and Reeves Units described above are being subjected to rigidly controlled water injection programs in the San Andres reservoir and are expected to have an economic life of

several more years and to generate a future net income of \$14,000,000 to the Company during this period.

Sale of Properties: During 1972, the Company sold a group of its isolated and lower income producing properties in Illinois, Nebraska, Oklahoma and Texas. Receipts from these sales totaled \$658,000. The Company thereby reduced its number of leases or Units by 22.76% while these same properties represented only 5.86% of the proven oil and 1.69% of the proven gas reserves attributable to Mid-Continent Division Properties.

Western Division

General: During 1972 the Company's net share of production declined from an average monthly rate of 43,550 barrels to 38,400 barrels of oil and from 161,000 Mcf to 156,000 Mcf of gas. The decrease resulted not from reduced producing capability, but principally from sharp curtailment of production from the Recluse Field in Wyoming, as mandated by the State Oil and Gas Supervisor. The Company's own operated production in California during 1972 remained practically unchanged from the previous year.

Wells Drilled

	Gross Wells		Net Wells	
	1972	1971	1972	1971
Development:				
Producers	92	74	24.91	10.88
Dry Holes	8	9	2.17	2.72
	100	83	27.08	13.60
Exploration:				
Producers	21	15	5.28	5.06
Dry Holes	47	41	10.55	11.28
	68	56	15.83	16.34
Total Wells:	168	139	42.91	29.94
Success Ratios:				
Development	92.0%	89.2%		
Exploration	31.3%	26.8%		

California

Wilmington Field: Reserve participated in redrilling two wells, one in each of the Fault Block IV and V Units. Both were producers, and this, together with extensive remedial and stimulation work, kept production decline to a minimum. The polymer injection experiment in Fault Block V was discontinued early in the year. Although it had indicated beneficial results from a reservoir standpoint, the cost involved was too great to justify continuance of the program. 99,571 barrels of oil were produced from the two Units in 1972 to Reserve's interest.

Banta Station Field: Reserve joined in the drilling of a new well in this area, known as Maciel Bros. 1-16. On completion, this well was tested at a rate of 1200 Mcf/D through a 5/16" choke from the B-1 sand at 3900 feet. Reserve has a 25% working interest in this well.

Vernalis Field: Tests made at 6 wells, using portable compressors, resulted in doubling production rates. Accordingly, a field wide compressor installation is planned, which should increase the Company's income from this field substantially.

Wyoming

Recluse Field: The Wyoming Oil and Gas Conservation Commission placed this field under their supervision as to individual well offtake rates, starting May 1, 1972. Each well has a monthly gas allocation, and with the rapidly increasing gas/oil ratios, this resulted in substantial curtailment of the Company's two producers. With the increasing demand for natural gas, it is expected that the stringency of this curtailment will be alleviated somewhat during 1973. Reserve has the full working interest in these wells from which 59,587 barrels of oil and 665,628 Mcf of gas were produced in 1972.

South Coyote Creek Field: During 1972 the Company joined in the drilling of two wells in this field, in order to complete development of the Dakota Sand. One was a dry hole and the other, Federal B-6, was completed as a producer. Installation of high volume lifting equipment is in progress, and oil production of the order of 100 B/D is expected from the new well. Reserve's working interest in the Dakota Sand is 40%.

tion'' areas covering 220,000 acres each.

These lands are located in the Napo-Putomayo Basin and are northerly and on trend with the prolific Lago Agria, Sacha and Shushufindi fields of Ecuador. The Contract areas surround the Orito (Colombia's largest) and Loro oil fields, and are adjacent to several smaller fields.

In the two Contract areas, the venture has an initial 3-year period to explore, and may extend this exploration period an additional 3 years. It is anticipated that exploratory drilling will be conducted by the venture on both Contract areas. Over a two-year period the venture will also conduct geophysical work on the 2.5 million acre seismic option area, and will then have right to

select various blocks for exploratory drilling under additional Contracts of Association. The entire venture will be conducted under Contracts with Ecopetrol, the Colombian Government oil agency.

Halbouty-Reserve U.S.A. Exploration Program

The Halbouty-Reserve U.S. Exploration Program terminated on December 31, 1972. The Program has several "carry-over" prospects which will be drilled in 1973, but no new prospects will be acquired. Six of the twelve discoveries made under the program continue to produce. Reserve owns a 15% net profits interest in this program.

Colombia

The Company has acquired a 12½% interest in an exploratory venture in Colombia, South America, on approximately 3,000,000 acres immediately north of the Ecuadorian-Colombian border. These venture lands consist of a seismic option area covering 2,545,000 acres, plus two "Contract of Associa-

Acreage and Producing Wells

	Working Interest Acreage					Royalty Acreage		Oil and Gas Wells	
	Gross Acreage	Undeveloped Acreage		Developed Acreage		Gross	Net	Gross	Net
		Gross	Net	Gross	Net				
United States									
California	35,544	7,024	5,456	28,520	4,521	2,772	75	923	90.61
Illinois	8,706	51	13	8,655	74	2,593	91	310	2.63
Kansas	25,155	21,958	10,949	3,197	311	14,382	185	5	.49
New Mexico	33,809	12,795	1,809	21,014	2,945	320	5	144	23.28
Oklahoma	11,838	440	190	11,398	357	13,820	22	220	6.16
Texas	55,092	2,584	1,270	52,508	11,020	104,174	196	491	92.39
Utah	22,065	22,065	20,296	—	—	—	—	—	—
Wyoming	144,089	90,286	81,132	53,803	2,561	—	—	22	.13
All Others	19,627	5,562	3,702	14,065	353	13,902	1,420	236	7.28
Total	355,925	162,765	124,817	193,160	22,142	151,963	1,994	2,351	222.97
Canada/Alaska									
British Columbia	648,329	465,788	117,593	182,541	39,329	116,402	2,439	136	16.58
Alberta	828,863	772,134	162,564	56,729	21,225	132,804	3,445	1,056	37.85
Saskatchewan	644,531	594,952	216,827	49,579	11,550	582,385	732	1,498	245.16
Manitoba	11,701	8,763	416	2,938	1,354	2,647	43	323	13.59
Northwest Territories	1,708,463	1,708,463	1,238,438	—	—	1,783,803	43,408	—	—
Yukon Territory	1,890,632	1,890,632	1,164,692	—	—	123,576	4,332	—	—
Arctic Islands	11,249,577	11,249,577	7,079,774	—	—	1,412,455	37,882	—	—
East Coast	5,044,770	5,044,770	1,633,421	—	—	—	—	—	—
Alaska	16,068	15,908	12,090	160	24	8,137	474	1	.09
Total	22,042,934	21,750,987	11,625,815	291,947	73,482	4,162,209	92,755	3,014	313.27
Grand Total	22,398,859	21,913,752	11,750,632	485,107	95,624	4,314,172	94,749	5,365	536.24

Apple Valley Ranchos

Important progress was made in the real estate development business conducted by Reserve, Apple Valley Ranchos Division, in the high desert resort area of Southern California. The result is that the community of Apple Valley will soon be served by two major shopping centers.

Alpha Beta Acme Markets, owner of over 200 markets throughout California, has purchased 7 acres in our Desert Knolls Manor No. 1 subdivision located on the north side of State Highway 18 in the Desert Knolls business area; and has made public their plans to develop approximately 87,350 square feet to house a supermarket, drug store, variety store and a full range of service and retail stores on the site.

The second center will result from the sale by Apple Valley Ranchos of 9 acres to FHM investments for the development of a modern shopping center at the corner of State Highway 18 and Navajo Road, adjacent to the existing "Village" commercial area. The center will feature a Safeway supermarket with related shops, including a drug store and variety store, and is located 5 miles east of the Alpha Beta site. These two centers will provide a wider selection of shopping alternatives for the residents of Apple Valley and their development will further enhance the total community concept that has been formulated through the Apple Valley Ranchos Division.

Gross revenues from Apple Valley Ranchos operations totaled \$5.0 million in 1972. These revenues, up 13% from 1971, were primarily provided by subdivided property sales and also included commission income from the sale of property owned by others, interest on land sales contracts, revenues from hotel operations and public utility water sales. Real estate sales for 1972, including sales of subdivided property for

others under exclusive sales agency contracts, amounted to \$3.0 million, up from similar sales in 1971 of \$2.2 million.

For the fourth consecutive year Apple Valley experienced an increase in construction, with 149 new structures started in 1972 compared with 107 new starts in 1971. Your Company does not engage in the construction business; however, increased activity in the construction field suggests a strong local economic pattern and reflects favorably upon the Company's substantial Apple Valley real estate holdings.

Apple Valley Inn has always been the primary social point for Apple Valley and its neighbors, and continues to be a popular hotel. A portion of the hotel remodeling has been completed. Most of the guest rooms and two of the dining-rooms, the Apple Valley Room and the Blossom Room, have been re-furnished and refurbished, offering a quietly luxurious atmosphere. The activities for guests include golf, tennis, horseback riding and swimming, all in the ideal climate and surroundings which Apple Valley Ranchos nurtured and protected long before ecology became a household word.

In subdivision activity at year-end, the development of 230 acres into 350 lots to be known as Desert Knolls Manor No. 2 and a 43 estate lot subdivision, including 9 spectacular mountain-top homesites, known as Desert Knolls Heights Unit No. 2, are progressing as scheduled. The new subdivisions are adjacent to the extremely successful Desert Knolls Manor No. 1 which opened in 1968, with sales exceeding \$6 million from that date. Both subdivisions will be ready for sale in the near future and should contribute substantially to 1973 results.

Other developments in the Apple Valley area during 1972 included dedication of the Cedar Springs Dam and Silverwood Lake, an important feature of the California State Water Project. The initial



Newton T. Bass
Chairman
of the Board

public reaction to this new recreational area was excellent and it should attract more visitors and residents to Apple Valley as the planned recreational facilities proceed toward completion.

Apple Valley Recreation and Park District, with the volunteer assistance of local members of Equestrian Trails, Inc., is developing a new Horseman's Center in Apple Valley to include a camper and trailer park, showhorse riding area, stock pens and a 400-foot long rodeo gymkhana arena.

The Mojave Forks Reservoir Dam recreational area and the new Mojave Narrows Regional Park continued with the development of their facilities during 1972 to the benefit of Apple Valley residents. The Valley continues to welcome both civilian and military personnel from George Air Force Base as residents.



Five miles north of Apple Valley Inn is the Apple Valley Airport served by Hughes Airwest. A new restaurant facility was completed in 1972 in the Spanish-Style Administration Building.

Among the people who have found an enjoyable way of life in Apple Valley are some of the finest professional men in the medical and dental field. Two new professional medical buildings are presently being constructed to complement the excellent St. Mary's Desert Hospital facilities.

Victor Valley College, at the western boundary of Apple Valley, is continuing its expansion program providing young students and adults of the community the opportunities of a wider range of business, agricultural, trade, vocational and general academic studies.

The Company's holdings of more than 9,500 acres of raw land will play a significant role in the growth of Apple Valley as additional subdivision planning progresses.

The 3,000-foot elevation, abundant fresh air, clear clean water and panoramic views, combined with management's carefully formulated plan providing large homesites with architectural control and open space, have created one of the country's finest ecological environments for casual living.



Top: Fishing at Silverwood Lake, just 20 miles from the heart of Apple Valley.

Center: Challenging 18-hole championship golf course available to guests of Apple Valley Inn.

Bottom: A scenic view near the Mojave Forks Reservoir Dam recreational area.

Mohawk Petroleum Corporation, Inc.

Mohawk Petroleum Corporation, Inc., a wholly-owned subsidiary of Reserve specializing in the oil refining and petroleum products marketing fields, again made substantial contributions to Reserve's sales, profits and working capital. Particularly in the marketing of gasoline, the company's principal product, Mohawk made outstanding progress. Sales increased 32% over 1971 to 136,132,939 gallons. This percentage, when added to increases achieved in both 1970 and 1971, has resulted in a cumulative 61% sales increase in the three years since Mohawk became a subsidiary of Reserve. These gains have been achieved by Mohawk's three marketing organizations — the Northern Division headquartered in San Francisco; the Central Division in Bakersfield; and the Southern Division in Los Angeles.

This outstanding progress has been accomplished with very nominal capital investment through two distinctly different programs. First, arrangements have been made with a number of independent gasoline distributors in Southern California and Arizona whereby Mohawk supplies gasoline and diesel oil to existing lessee-operated retail service stations owned or leased by such distributors. In turn, these service stations have been converted to the Mohawk brand. 76 branded service stations have been added to Mohawk's outlets in the past two years under this program. This expansion of the company's Mohawk Indianhead brand has resulted in a 45% increase in the use of Mohawk credit cards over this period.

Secondly, the company has participated actively in the relatively new but rapidly expanding concept of marketing gasoline through low-cost installations in connection with small consumer-oriented merchandising businesses such as Drive-in dairy stores, Convenience Food Marts and liquor stores. Installation of tanks, pumps and remote control automated read-out devices are financed by Mohawk, with investment repaid by the

store owner in from three to five years. With continually increasing California land and construction costs, this approach offers greater return in relation to investment than the construction of conventional service stations. 18 of these outlets selling Mohawk products re-branded to other trade names were constructed during 1972, bringing to 68 the total number of such outlets which have been financed by the company since inception of this program.

In total, Mohawk products are marketed through 307 retail outlets (up from 241 in 1971) comprising 190 Mohawk branded service station and 117 outlets selling Mohawk products re-branded to other trade names, plus 93 jobbers, commercial customers and other accounts located in 165 cities and towns in California and Arizona.

Mohawk continues to be an important manufacturer and supplier of diesel oil. During 1972 the company sold 57,693,957 gallons of this fuel, an increase of 18% over 1971, to truck operators, farmers, other refiners and to a nationwide railroad on whose main line the Bakersfield refinery is located. In addition, the company sold 12,168,151 gallons of jet fuel to the Defense Fuel Supply agency for use by the United States military forces, and increased its sales of weed oil to the San Joaquin Valley farming community by some 39%.

As a result of its continued marketing expansion, Mohawk now sells a greater volume of petroleum products than is produced by its Bakersfield refinery. The difference between its manufacture and marketing requirements is acquired from other refineries in California. During

1972, Mohawk's refinery at Bakersfield, California processed 5,976,507 barrels (16,329 B/D) of high gravity San Joaquin Valley crude oils supplied under contracts with a major oil company, numerous independent producers and the United States Navy. In addition, Mohawk purchases United States Government royalty oil from on-shore leases in California and Alaska, and late in 1972 signed the first contract executed on the West Coast with the United States Geological Survey covering the government's royalty share of Outer Continental Shelf crude oil from an important producing field located off-shore Santa Barbara County. This oil is being delivered to a major oil company in exchange for San Joaquin Valley crude delivered into Mohawk's refinery.

During 1972 the company received licenses to import, and imported 2,858,826 barrels (7,811 B/D) of foreign crude, which it delivered to a major oil company at point of importation in exchange for crude oil delivered by pipeline into the Bakersfield refinery. Upward adjustments in the posted prices for Persian Gulf crudes during 1972 resulted in higher costs for this portion of Mohawk's raw material.

In general, operations at the Bakersfield refinery remained static during 1972. Inadequate supplies of California crude oil available to refiners have resulted from continuing decline of local producing fields, while environmental forces have blocked construction of the Trans-Alaskan pipeline and development of recent important Outer Continental Shelf discoveries, both of which represent critically needed new supply sources for the industry. Continued failure of the

Operating Highlights 1972

Refinery Thruput	5,976,507 Barrels	16,329 Barrels per Day
Gasoline Sales	136,132,939 Gallons	11,344,412 Gallons per Month
Diesel & Stove Oil Sales	58,284,270 Gallons	4,857,023 Gallons per Month
Jet Fuel Sales	12,168,151 Gallons	1,014,013 Gallons per Month



New Mohawk service station at 986 Third Street, Yuma, Arizona

Federal government to resolve and clarify environmental regulations affecting ambient air standards, automobile emissions and fuel composition make it unwise to proceed with any program of refinery expansion or modernization until the ground rules covering these important specifications are fully promulgated. In addition, stabilization of the Mandatory Oil Import Program is essential before the refining industry can program and finance long-range plans.

At this time Mohawk has under negotiation arrangements with others which it believes will result in access to new sources of crude oil, and it remains hopeful that environmental issues and oil import policies will be resolved by the Federal government during 1973. These circumstances will make possible implementation of its program of refinery modernization and expansion.



The 4 pictures depict gasoline outlets supplied by Mohawk which illustrate the relatively new but rapidly expanding concept of marketing gasoline through low-cost installations in connection with small consumer-oriented merchandising businesses. The outlets shown are located in the Metropolitan Los Angeles area.

Consolidated Balance Sheet

December 31, 1972 and 1971

Assets	1972	1971
	(In Thousands)	
Current assets:		
Cash—including certificates of deposit in 1972 of \$3,700,000	\$ 6,960	\$ 2,779
Marketable securities, at cost which approximates market	3,178	1,712
Accounts receivable	7,171	5,953
Installment contracts, commissions and notes receivable, net	929	769
Inventories	3,938	3,757
Prepaid expenses	1,056	1,199
Total current assets	<u>23,232</u>	<u>16,169</u>
Long term receivables and investments:		
Installment contracts, commissions and notes receivable, net	5,142	4,588
Undeveloped land and other investments, at lower of cost or market	692	1,062
	<u>5,834</u>	<u>5,650</u>
Properties, at cost:		
Oil and gas properties	77,881	76,410
Refining, manufacturing and distributing facilities	13,626	11,506
Commercial and other properties	6,790	6,670
	<u>98,297</u>	<u>94,586</u>
Less accumulated depletion and depreciation	40,754	40,535
	<u>57,543</u>	<u>54,051</u>
	<u>\$86,609</u>	<u>\$75,870</u>
Liabilities and Shareholders' equity		
Current liabilities:		
Notes payable, current portion	\$ 1,033	\$ 18
Accounts payable and accrued liabilities	8,623	6,033
Refined oil products due under exchange agreements	1,240	—
Total current liabilities	<u>10,896</u>	<u>6,051</u>
Notes and other long-term payables	8,670	7,968
Deferred Canadian income taxes	863	675
Minority interest	2,903	2,642
Shareholders' equity:		
Capital stock:		
Convertible preferred stock, \$25 par and involuntary liquidating value: authorized 400,000 shares; 1972—issued 310,757 shares (including 2,558 treasury shares)	7,769	7,771
Common stock, \$1 par value: authorized 15,000,000 shares; 1972—issued 9,334,229 shares (including 6,041 treasury shares)	9,334	9,334
Capital surplus	17,013	16,987
Retained earnings	29,213	24,494
Treasury stock, at cost, 2,558 shares Series B preferred shares and 6,041 common shares	(52)	(52)
Total shareholders' equity	<u>63,277</u>	<u>58,534</u>
	<u>\$86,609</u>	<u>\$75,870</u>

See accompanying Financial Review and Summary of Accounting Policies.

Consolidated Statement of Income and Retained Earnings

Years ended December 31, 1972 and 1971

	1972	1971
	(In Thousands)	
Revenues:		
Petroleum product sales	\$50,542	\$42,729
Real estate sales and commission income	3,214	2,837
Other income—including interest income: 1972—\$810,000, 1971—\$806,000	2,869	2,893
	<u>56,625</u>	<u>48,459</u>
Costs and expenses:		
Cost of petroleum products sold and operating expenses	38,522	31,601
Cost of real estate sold and repossession losses	653	807
Selling and administrative expenses	6,921	7,039
Depletion, depreciation and abandonments	4,806	4,103
Interest expense	603	708
Minority interest	235	186
Federal, state and Canadian income taxes	910	409
	<u>52,650</u>	<u>44,853</u>
Income before extraordinary items	3,975	3,606
Extraordinary items	<u>1,168</u>	<u>200</u>
Net income	5,143	3,806
Retained earnings, beginning of year (after restatement)	24,494	21,112
Dividends paid on preferred stock	<u>(424)</u>	<u>(424)</u>
Retained earnings, end of year	\$29,213	\$24,494
Per share of common stock:		
Income before extraordinary items	\$.38	\$.34
Extraordinary items	<u>.13</u>	<u>.02</u>
Net income	<u>\$.51</u>	<u>\$.36</u>

Consolidated Statement of Changes in Financial Position

Years ended December 31, 1972 and 1971

	1972	1971
	(In Thousands)	
Source of funds:		
Operations:		
Income before extraordinary items	\$ 3,975	\$ 3,606
Items not involving working capital		
Depletion, depreciation and abandonments	4,806	4,103
Net additions to non-current receivables arising from land sales, less deferred profit realized	(280)	(561)
Provision for income tax offset by extraordinary items	700	200
Other (including minority interest)	429	278
	<u>9,630</u>	<u>7,626</u>
Extraordinary items less items not involving working capital	754	—
Total from operations	<u>10,384</u>	<u>7,626</u>
Collections on other long-term notes receivable	716	206
Proceeds from sales of stock by subsidiary	56	5,904
Proceeds from loans	1,678	2,283
Proceeds from sale of properties	1,527	813
Other	291	487
	<u>14,652</u>	<u>17,319</u>
Disposition of funds:		
Additions to properties	6,979	9,028
Principal applications to production payments	2,623	3,282
Payments and other decreases in long-term liabilities	1,021	3,914
Additions to other long-term notes receivable	1,095	437
Dividends paid on preferred stock	424	424
Other	292	210
	<u>12,434</u>	<u>17,295</u>
Increase in working capital	\$ 2,218	\$ 24

See accompanying Financial Review and Summary of Accounting Policies.

Financial Review

Earnings and revenues: Reserve's consolidated net income in 1972 amounted to \$5,143,000, equal to \$.51 per share on the 9,328,111 average common shares outstanding during the year and includes extraordinary credits of \$1,168,000 (\$.13 per share). In 1971, Reserve's restated net income was \$3,806,000 (\$.36 per share), including an extraordinary credit of \$200,000 (\$.02 per share).

Reserve's revenues reached a record high in 1972 of \$56,625,000, an increase of \$8,166,000 over restated revenues of \$48,459,000 reported in 1971.

Changes in financial position: Funds generated from your Company's operations amounted to \$10,384,000 in 1972 and compares with funds so generated of \$7,626,000 in 1971, as restated. Other funds provided included \$1,678,000 borrowed primarily under bank credit agreements. Major expenditures of funds included \$6,979,000 for additions to properties and \$2,623,000 for production payment principal applications.

Working capital amounted to \$12,336,000 at the end of 1972, and compares with \$10,118,000 at the end of 1971, as restated. The changes in the various elements of working capital are as follows:

	1972	1971	1970
	(In Thousands)		
Increase (decrease) in current assets:			
Cash	\$4,181	\$(977)	\$ 706
Marketable securities	1,466	(239)	(793)
Accounts receivable	1,218	813	(805)
Installment contracts, commissions and notes receivable	160	(390)	(380)
Inventories	181	848	(252)
Prepaid expenses	(143)	283	(102)
	<u>7,063</u>	<u>338</u>	<u>(1,626)</u>

Working Capital (continued)

Increase (decrease) in current liabilities:			
Notes payable, current portion	1,015	(93)	(889)
Accounts payable and accrued liabilities	2,590	493	(733)
Refined product exchange payable	1,240	(86)	(1,152)
	<u>4,845</u>	<u>314</u>	<u>(2,774)</u>
Increase in working capital	<u>\$2,218</u>	<u>\$ 24</u>	<u>\$ 1,148</u>

Installment contracts, commissions and notes receivable:

These receivables totaled \$6,071,000 at the end of 1972 compared with \$5,357,000 at the end of 1971, after allowance for loss (\$114,000 in 1972; \$127,000 in 1971) and deferred profit on residential land sales contracts and commissions receivable (\$5,374,000 in 1972; \$5,941,000 in 1971). The gross amount of receivables arising from sales of commercial properties was \$1,644,000 and the gross amount of residential land sales contracts and commissions receivable was \$8,050,000 at the end of 1972 (\$8,627,000 at the end of 1971). These receivables bear interest at the stated rate of 6%. Annual maturities approximate \$1,275,000 in 1973 and decline approximately \$50,000 per year to \$1,000,000 in 1977.

Inventories, at the end of 1972 and 1971 are as follows:

	1972	1971
	(In Thousands)	
Petroleum products	\$1,589	\$1,613
Chemical products	259	263
Subdivided land, principally under development	1,482	1,288
Materials and supplies	608	593
	<u>\$3,938</u>	<u>\$3,757</u>

Notes and other long-term payables:

At December 31, 1972, long-term debt amounted to \$8,670,000, an increase of \$702,000 from the \$7,968,000 payable at December 31, 1971. Long-term debt consisted of the following:

	1972	1971
	(In Thousands)	
Note payable to bank, at 1/2 % above prime; due \$250,000 quarterly beginning March 31, 1973	\$6,000	\$6,100
Production loan (6 1/2 %) due 1973 to 1976	1,501	992
Other	1,169	876
	<u>\$8,670</u>	<u>\$7,968</u>

The bank debt agreement requires, among other things, the maintenance of minimum net worth, working capital equal to 10% of defined net worth, and prohibits the payment of cash dividends on Reserve's common stock.



Clockwise from McMillan, center foreground: Bass, Westlund, Hellman, Holloway, McDuffie, Green, Aberley, Ball, Pyle, Bixby, Cramer, Meadows.

Stock option plans: Reserve has several stock-option plans for officers and key employees, approved by stockholders at various times, under which options may be granted at the market price at the date of grant, but cannot be exercised until at least one year after date of grant. Options expire five years after date of grant. At December 31, 1971, options were outstanding for 223,000 shares of the Company's common stock and 89,000 shares were available for the granting of additional options. During 1972, options for 8,000 shares were granted and options for 8,500 shares were cancelled. At December 31, 1972, options were outstanding for 222,500 shares at prices ranging from \$5.875 to \$17.75 per share, an aggregate of \$2,529,000. At that same date options for 214,500 shares were exercisable and 89,500 shares were available for the granting of future options.

In addition, Canadian Reserve has granted to certain of its officers and employees options to purchase 160,500 shares (123,000—1971 and 37,500—1972) of its capital stock at an aggregate price of \$769,000. At December 31, 1972, 39,500 shares were available for the granting of future options.

Capital stock: Reserve has four series of 5½ % cumulative, convertible, voting (except Series C), preferred stock. Shares issued as of December 31, 1972 follow: Series A—23,751, Series B—103,816 (includes 2,558 treasury shares), Series C—9,600 and Series D—173,590. Such shares are convertible into common stock at various rates and are callable by the Company at various times and at amounts up to 106% of par value.

Regular quarterly dividends were paid in 1972 on the four issues of preferred at the rate of \$1.375 per share aggregating \$424,000.

During 1972, 62 shares of preferred stock (734 in 1971) were converted into 164 shares of common stock (1,667 in 1971). At December 31, 1972, 1,033,418 shares of common stock were reserved for issuance as follows: 613,814 shares for conversion of preferred stock; 312,000 shares in connection with stock options; and 107,604 shares in connection with warrants arising out of 1969 acquisitions, exercisable at \$13.94 per share through September 15, 1974.

Capital surplus: In February 1971, Canadian Reserve sold 1,000,000 new shares of its common stock to the

Canadian public for cash which reduced Reserve's ownership to 89.5%. As a result of the sale, Reserve increased capital surplus by \$2,729,000. In 1972, Canadian Reserve granted, under a stock purchase plan, 11,853 shares of its common stock to certain employees for \$11,853 and charged \$54,000 to expense. As a result, Reserve increased capital surplus by \$25,000. Capital surplus was also increased by \$1,000 (\$17,000 in 1971) as a result of conversions of preferred stock.

Land sales activity during the last three years is summarized as follows:

Real estate sales and commission income:

	1972	1971	1970
	(In Thousands)		
Real estate sales:			
Residential property sales	\$1,103	\$1,445	\$2,053
Commercial property sales	1,745	758	506
	<u>2,848</u>	<u>2,203</u>	<u>2,559</u>
Deferred profit on residential sales	(684)	(839)	(1,282)
Deferred profit on residential sales realized on collections	613	758	751
Imputed interest on receivables arising from commercial sales	(135)	—	—
	<u>2,642</u>	<u>2,122</u>	<u>2,028</u>
Commission income	572	715	954
	<u>\$3,214</u>	<u>\$2,837</u>	<u>\$2,982</u>

Cost of real estate and repossession losses:

	1972	1971	1970
	(In Thousands)		
Cost of real estate sold:			
Residential property sold	\$ 259	\$ 396	\$ 473
Commercial property sold	252	312	58
	<u>511</u>	<u>708</u>	<u>531</u>
Repossession losses on residential property sales	41	55	30
Allowance for loss on commercial property receivables	101	44	44
	<u>\$ 653</u>	<u>\$ 807</u>	<u>\$ 605</u>



Seven Year Statistical Summary of Consolidated Operations

Financial:

Amounts in thousands of dollars	1972	1971	1970	1969	1968	1967	1966
Revenues (from continuing operations)	\$56,625	\$48,459	\$42,021	\$43,175	\$38,392	\$37,623	\$33,853
Income before extraordinary items	3,975	3,606	2,785	2,856	2,627	3,136	2,372
Extraordinary credits (charges)	1,168	200	(6,670)	1,323	216	228	—
Net income (loss)	5,143	3,806	(3,885)	4,179	2,843	3,364	2,372
Net income (loss) per common share	.51	.36	(.46)	.42	.30	.38	.25
Working capital	12,336	10,118	9,626	8,154	8,811	8,856	6,869
Reserved production payments outstanding	—	2,626	5,144	7,689	10,243	12,852	15,672
Shareholders' equity	63,277	58,534	52,423	56,795	41,817	36,567	33,678
Total assets	86,609	75,870	68,903	75,722	69,743	65,429	49,862

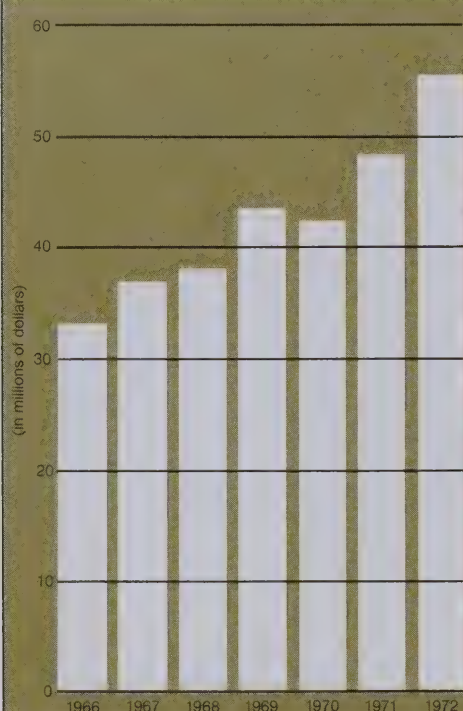
Other:

Average common shares outstanding (in thousands)	9,328	9,328	9,324	8,933	8,028	7,813	7,804
Crude oil and natural gas liquids production, barrels per day	10,028	9,683	9,734	9,706	9,375	9,110	8,402
Natural gas sales Mcf per day	35,955	34,122	35,363	40,053	37,996	37,853	39,674

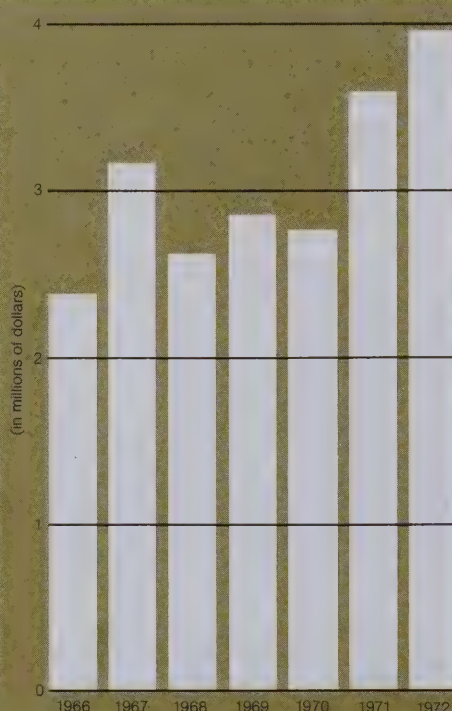
Notes:

- (1) 1971 and prior years restated to account for retail residential land sales on the installment method.
- (2) Full-cost method of accounting adopted by Canadian subsidiary effective 1/1/71.

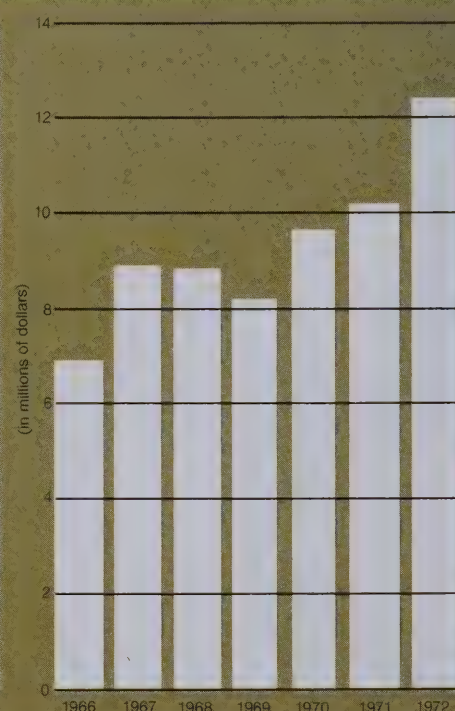
Revenues from continuing operations



Income before extraordinary items



Working Capital



Summarized income statements for the years ended December 31, 1968 and December 31, 1969, after restatement, are as follows:

	1968	1969
	(In Thousands)	
Revenues	\$38,392	\$43,175
Costs and expenses	35,599	39,932
Income from continuing operations	2,793	3,243
Loss from discontinued operations	(166)	(387)
Income before extraordinary items	2,627	2,856
Extraordinary items	216	1,323
Net income	<u>\$ 2,843</u>	<u>\$ 4,179</u>
Per share of common stock:		
Income from continuing operations	\$.29	\$.31
Loss from discontinued operations	(.02)	(.04)
Extraordinary items	.03	.15
Net income	<u>\$.30</u>	<u>\$.42</u>

Consolidated Statement of Operations and Retained Earnings

Year ended December 31, 1970

	1970
	(In Thousands)
Revenues:	
Petroleum product sales	\$36,235
Real estate sales and commission income	2,982
Other income— including interest income of \$707,000	2,804
	<u>42,021</u>
Costs and Expenses:	
Cost of petroleum products sold and operating expenses	25,316
Cost of real estate sold and repossession losses	605
Selling and administrative expenses	7,038
Depletion, depreciation and abandonments	3,890
Interest expense	1,006
Federal, state and Canadian income taxes	615
	<u>38,470</u>
Income from continuing operations	3,551
Loss from discontinued operations	(766)
Extraordinary items	(6,670)
Net loss	<u>(3,885)</u>
Retained earnings, beginning of year (after restatement)	25,425
Dividends paid on preferred stock	(428)
Retained earnings, end of year	<u>\$21,112</u>
Per share of common stock:	
Income from continuing operations	\$.34
Loss from discontinued operations	(.08)
Extraordinary items	(.72)
Net loss	<u>\$ (.46)</u>

In 1970, the Company discontinued the operation of its fertilizer plant. Accordingly, revenues of \$1,390,000 and allocated income tax benefit of \$651,000 are included as discontinued operations in the consolidated statement of operations.

Consolidated Statement of Changes in Financial Position

Year ended December 31, 1970

	1970
	(In Thousands)
Source of funds:	
Operations:	
Income before extraordinary items	\$ 2,785
Items not involving working capital:	
Depletion, depreciation and abandonments (including \$563,000 applicable to discontinued operations)	4,453
Net additions to noncurrent receivables arising from land sales, less deferred profit realized	(890)
Other	38
	<u>6,386</u>
Extraordinary items, less items not involving working capital	96
Total from operations	6,482
Collections on other long-term notes receivable	205
Proceeds from loans	4,224
Proceeds from sale of properties	168
Other	506
	<u>11,585</u>
Disposition of funds:	
Additions to properties	4,830
Principal applications to production payments	4,151
Payments and other decreases in long-term liabilities	658
Additions to other long-term notes receivable	121
Dividends paid on preferred stock	428
Other	249
	<u>10,437</u>
Increase in working capital	<u>\$ 1,148</u>

Extraordinary items consist of the following:

	1972	1971	1970
	(In Thousands)		
Federal income tax reduction attributable to loss carry-forwards	\$ 817	\$200	\$ —
Gain on sale of fertilizer plant, less income tax of \$117,000	351	—	—
Provision for loss on disposition of fertilizer plant, less reduction of deferred income tax of \$584,000	—	—	(6,766)
Income tax adjustment related to sale of oil and gas property in prior year	—	—	96
	<u>\$1,168</u>	<u>\$200</u>	<u>\$ (6,670)</u>

Subsequent event: Reserve has agreed to acquire all the outstanding stock of Western Crude Oil, Inc. by issuing approximately 2,943,000 shares of its common stock. The acquisition is subject to approval by the shareholders of both companies.

Company's Net Share Oil and Gas Sales—1972

	Crude Oil and Natural Gas Liquids-Bbls.	Dry and Casinghead Gas-MCF
Texas	670,241	3,945,854
California	281,577	1,214,026
Wyoming	166,723	684,532
Louisiana	82,931	—
Nebraska	41,953	—
Illinois	38,679	—
New Mexico	25,919	398,558
Oklahoma	17,563	105,886
Saskatchewan	1,474,379	73,318
Alberta	533,807	5,992,056
British Columbia	242,374	625,644
Manitoba	83,232	—
All Others	10,925	119,629
Totals	3,670,303	13,159,503
Average per day	10,028	35,955

Note: The above tabulation includes production applied to the retirement of production payments.

Summary of Accounting Policies

Principles of consolidation. Accounts of wholly- and majority-owned subsidiaries are included in the consolidated financial statements.

Foreign exchange. The accounts of Canadian Reserve have been translated to U.S. dollar equivalents at appropriate rates of exchange using the current—noncurrent method. Translation gains or losses are included in operating results.

Land sales—residential. Reserve has retroactively adopted the installment method of accounting for its retail sales of residential lots and has deferred direct selling expenses related to retail sales and commissions in accordance with provisions of the accounting guide “Accounting for Retail Land Sales” recently adopted by the American Institute of Certified Public Accountants.

Under the installment method, revenues include: the total selling price of property sold in the year of the sale, a charge representing deferral of gross profit, net of direct selling expenses, applicable to future collections and a credit for the gross profit on current collections. Cost of sales, indirect selling and administrative expenses are charged to expense as incurred. Reserve previously reported sales of lots on the accrual method and charged direct selling expenses to expense as incurred. Reserve retroactively adjusted retained earnings at December 31, 1969 by \$1,194,000 and eliminated deferred tax credits of \$1,293,000; retained earnings as previously reported at December 31, 1970 and 1971 were reduced by \$2,595,000 and \$2,462,000, respectively. The effect of the accounting change is to increase (decrease) income previously reported (in thousands of dollars) as follows: continuing operations—1971—\$(67); 1970—\$(58); 1969—\$(103); 1968—\$(131); discontinued operations—1970—\$(50); and extraordinary items—1971—\$200; 1970—\$(1,293); 1969—\$(100); 1968—\$(117). The effect on per share

amounts is as follows: continuing operations—1971—\$(.01); 1969—\$(.01); 1968—\$(.02); and extraordinary items—1971—\$.02; 1970—\$(.15); 1969—\$(.01); 1968—\$(.01). Reserve earns commissions under exclusive sales agency contracts on sales of subdivided land owned by others. Such commissions (net of directly related expenses) are recorded as income when collected.

Land sales—commercial. Reserve records sales of commercial property on the accrual basis of accounting upon receipt of a 20% down payment and execution of a contract. The contract rate of interest charged to commercial land customers is 6%. In 1972 Reserve imputed interest on commercial sales contracts at the current market rate (12%).

Inventories of crude oil, refined products and chemical products are carried at average cost, which is lower than market. Materials and supplies are carried at or below average cost. Subdivided land is carried at cost which is less than market. Property taxes and interest relating to subdivided land are expensed as incurred.

Reserved production payments are added to the cost of acquired properties. The unpaid balance of the production payments (\$2,626,000 in 1971) is payable solely out of production from certain properties and is deducted in arriving at the carrying value of such properties. Sales (\$2,710,000 in 1972; \$2,882,000 in 1971; \$3,083,000 in 1970) and interest expense (\$98,000 in 1972; \$214,000 in 1971; \$380,000 in 1970) which are applied to production payments are included in the consolidated statement of income.

Exploratory and leasehold costs.

Expenditures for oil and gas exploration (including geological and geophysical costs, delay drilling rentals and dry hole costs) are expensed as incurred, and costs of acquiring non-producing mineral

rights are capitalized and charged to expense when surrendered, except that such expenditures incurred by Canadian Reserve after December 31, 1970, are capitalized and amortized under the full-cost method of accounting. The effect of changing to the full-cost method for Canadian Reserve was to increase 1971 consolidated income by \$540,000 (\$.06 per share) and the estimated 1972 increase is approximately \$900,000 (\$.10 per share).

Properties. Depletion and depreciation of the costs of oil properties and related equipment and amortization of capitalized intangible drilling costs are computed on the unit-of-production basis; buildings and other equipment are depreciated by the straight-line and declining balance methods at rates varying from 2½ % to 33⅓ % per annum.

Maintenance and repairs are expensed as incurred; renewals and replacements which improve or extend the life of existing properties are capitalized and depreciated. Gain or loss is recognized upon sale or retirement of assets depreciated on the straight-line or declining balance method. For properties depreciated on the unit-of-production method, the cost of the asset sold or retired, less the amount realized, is charged to accumulated depreciation.

Income taxes. Reserve provides for deferred income taxes applicable to transactions which affect book and taxable income in different years (principally depreciation and sales of commercial land and oil and gas properties reported for income tax purposes on the installment method). No provision for deferred tax is made for differences of a permanent nature such as those arising from statutory depletion and intangible drilling

Accountants' Report

Arthur Young & Company

The Board of Directors and Shareholders
Reserve Oil and Gas Company

costs. No provision is made for U.S. income taxes attributable to earnings of Canadian Reserve as it is anticipated that accumulated earnings of \$10,500,000 will be permanently invested in Canada. In consolidation, Reserve eliminates a portion of deferred Canadian taxes (\$127,000 in 1972; \$170,000 in 1971; \$84,000 in 1970) to conform with Reserve's method of accounting. At December 31, 1972 Reserve has a net operating loss carryforward for tax purposes of approximately \$5,000,000 which expires as follows: \$1,200,000 in 1975; \$600,000 in 1976 and \$3,200,000 in 1977.

Pension Plan. Reserve has adopted a pension plan subject to shareholder approval which will be effective January 1, 1973 and which will cover eligible U.S. employees. A subsidiary has an existing pension plan which will be incorporated into the new plan. Total pension expense for 1973 is expected to approximate \$193,000 (an increase of \$121,000), including amortization of prior service cost. Prior service cost is estimated to be \$2,000,000 and will be amortized over a 40 year period. Reserve's policy will be to fund pension cost accrued.

Per share data. Income (loss) per share of common stock is based on the weighted average shares outstanding, after deduction of preferred dividend requirements. Assuming conversion of outstanding preferred stock and exercise of outstanding stock options and warrants at the beginning of the year, there would have been no dilution of the per-share amounts.

We have examined the accompanying consolidated balance sheet of Reserve Oil and Gas Company at December 31, 1972 and December 31, 1971 and the related consolidated statements of income and retained earnings and changes in financial position for the two years ended December 31, 1972. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances. We have also performed a similar examination of the consolidated statements of operations and retained earnings and changes in financial position for the year ended December 31, 1970 included in the Financial Review.

In our opinion, the statements mentioned above present fairly the consolidated financial position of Reserve Oil and Gas Company at December 31, 1972 and December 31, 1971 and the consolidated results of operations and changes in financial position for the three years ended December 31, 1972 in conformity with generally accepted accounting principles applied on a consistent basis during the period after restatement, which we approve, for the retroactive change in accounting for retail land sales and except for the change commencing January 1, 1971, to which we do not object, in the method of accounting for exploration and development costs incurred in Canada, as described in the summary of accounting policies under the captions "land sales—residential" and "exploratory and leasehold costs," respectively.

Arthur Young & Company

San Francisco, California
February 14, 1973

Principal Subsidiaries

Canadian Reserve Oil and Gas Ltd.

639 - 5th Avenue, S.W., Calgary, Alberta T2P 0M9, Canada
Paul D. Meadows, President

Mohawk Petroleum Corporation, Inc.

550 South Flower Street, Los Angeles, California 90017
Malcolm McDuffie, President

Division and Other Offices

Executive Offices:

550 South Flower Street, Los Angeles, California 90017

Apple Valley Ranchos Division

P.O. Box 1, Apple Valley, California 92307
Walter E. Cramer, Jr., Vice President

Mid-Continent Division

1806 Fidelity Union Tower, Dallas, Texas 75201
John M. Penrod, Manager

Transfer Agents

Security Pacific National Bank, Corporate Trust Division

124 West Fourth Street, Los Angeles, California 90013

The Chase Manhattan Bank, N.A.

One Chase Manhattan Plaza, New York, New York 10015

Guaranty Trust Company of Canada, 311-8th Ave., S.W.

Calgary, Alberta, Canada

Registrars

The Bank of California, N.A.

550 South Flower Street, Los Angeles, California 90017

First National City Bank

55 Wall Street, New York, New York 10005

Guaranty Trust Company of Canada, 311-8th Ave., S.W.

Calgary, Alberta, Canada

Stock Exchange Listings

American Stock Exchange

Pacific Coast Stock Exchange

Shareholders and Employees

Shareholders	20,214
Employees	609



